S&P Global Ratings

Research

Research Update:

Swedish Truck Maker Scania Outlook Revised To Stable After Same Action On VW; 'BBB+/A-2' Ratings Affirmed

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Overview

- We have revised our outlook on Scania's parent Volkswagen AG (VW), to stable from negative, due to the company's stabilized performance.
- We align our outlook on Scania with that on VW because VW controls 100% of Scania.
- We are therefore revising our outlook on Scania to stable from negative and affirming our 'BBB+/A-2' ratings.
- The stable outlook reflects the outlook on VW and our expectation that Scania will maintain low debt and positive free operating cash flow (excluding the captive finance operations) over 2018-2020.

Rating Action

On Nov. 8, 2017, S&P Global Ratings revised its outlook on Sweden-based heavy vehicle manufacturer Scania AB (publ.) to stable from negative. We also affirmed our 'BBB+/A-2' long- and short-term corporate credit ratings, 'K-1' Nordic regional scale rating, and 'zaAAA/zaA-1+' South Africa national scale ratings on Scania.

At the same time, we affirmed our 'BBB+' issue ratings on Scania's senior unsecured bonds.

Rationale

The outlook revision reflects a similar rating action on Scania's Germany-based parent company Volkswagen AG (VW; BBB+/Stable/A-2). We do not observe any substantial change in Scania's stand-alone credit profile, which we continue to assess at 'bbb+'. Our assessment includes a potential contingent liability for Scania of approximately €880 million from an EU fine for alleged collusive behavior in 1997-2011, which we understand Scania intends to appeal. In our view, Scania has headroom under its financial risk profile should the contingent liability become due in the future.

Based on Scania's reported figures in the first nine months of 2017, we believe our base-case assumptions are relatively conservative, even though the company's performance in some markets shows some deviations. Softer-than-expected truck deliveries in Europe are offset by consistent growth in Latin America and Asia. Order bookings for trucks are up 27%

compared with those in the first nine months of 2016, underlining solid fundamentals for the group's performance in 2017.

In our base case for Scania, we assume:

- Over-the-cycle truck sales will correlate closely with economic growth, with slower-than-expected growth denting sales volumes. For 2017, we assume 3.5% GDP growth globally, including about 1.6% in the EU.
- Mid-single-digit percentage increases in Scania's revenues in 2017 and 2018, owing to high volumes. This predominantly reflects our expectations of continued strong demand for trucks in Europe, partly offset by weak market conditions in South America. Replacement needs should, in our view, continue to fuel demand in Europe.
- Average capital expenditures (capex) of SEK8 billion per year.
- An annual dividend of 50% of net income, in accordance with Scania's financial policy, after a significant dividend to VW in 2015.
- No material acquisitions.
- No material disposals.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted operating margins of approximately 8%.
- Adjusted funds from operations (FFO) to debt above 100%.
- Adjusted debt to EBITDA below 1x.

Liquidity

We assess Scania's liquidity as strong, based on our projection that the company's ratio of potential sources of liquidity to uses will exceed 1.5x in 2017 and stand at least at 1.0x 2018. In our view, management has a proactive approach to financing, and we believe that liquidity would remain sufficient to cover uses even if EBITDA fell by 30%. Other supportive factors include Scania's solid relationships with its banks and its likely ability to absorb high-impact, low-probability events without refinancing. We observe that Scania chose not to tap the unsecured Eurobond market at the time of the emissions scandal involving VW. The company did not have difficulty meeting its liquidity needs, however, thanks to its well-managed liquidity position. Our assessment does not include any litigation-related contingent liability.

Principal liquidity sources:

- Cash and liquid assets of around SEK11 billion on Sept. 30, 2017.
- About SEK28 billion in undrawn fully committed credit facilities, maturing beyond 12 months.
- Our expectation of FFO of more than SEK11 billion per year, on average, in 2017 and 2018.

Principal liquidity uses:

- Debt maturities of around SEK15 billion per year on average in the next two years.
- Some working capital outflow that we estimate at SEK2 billion on average.
- Annual capex of SEK6 billion-SEK7 billion.
- Annual dividends of SEK1.7 billion-SEK1.9 billion.

Scania's financial agreements contain no financial covenants.

Outlook

The stable outlook on Scania reflects the outlook on its parent VW, and our expectation that Scania will maintain low debt and positive free operating cash flow (excluding the captive finance operations) over 2018-2020.

Downside scenario

Downside rating potential is predominantly tied to the rating on VW. We could also lower the rating on Scania if, in our view, Scania's stand-alone credit profile had deteriorated to below that of VW. This would most likely result from further distributions to VW that triggered a material deterioration of Scania's credit metrics, which we see as unlikely at this stage.

Upside scenario

We believe rating upside is limited for Scania, since it is contingent upon an upgrade of VV and, simultaneously, an improvement of Scania's stand-alone credit profile. As long as we believe that Scania remains exposed to its parent's capacity and willingness to tap its funds, as occurred in 2016 when Scania paid a sizeable dividend to VW, the likelihood of an upgrade is remote.

Ratings Score Snapshot

Corporate credit rating: BBB+/Stable/A-2

Business risk: Satisfactory
- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Strong

Financial risk: Minimal
- Cash flow/leverage: Minimal

Anchor: a-

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Negative (-1 notch)
- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)
- Captive Finance: Neutral (no impact)

Stand-alone credit profile: bbb+

Group credit profile: bbb+
- Entity status within group: Highly strategic

Issue Ratings

Capital Structure

Scania's capital structure consists of senior unsecured debt issued at core subsidiaries (Scania CV AB).

Analytical Conclusions

The debt is rated 'BBB+', the same as the long-term corporate credit rating, since no significant elements of subordination risk are present in the capital structure. This is also supported by the company's low leverage, resulting in our view of minimal financial risk.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology: The Impact Of Captive Finance Operations On Nonfinancial Corporate Issuers, Dec. 14, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- German Automaker Volkswagen Outlook Revised To Stable From Negative; 'BBB+/A-2' Ratings Affirmed, Nov. 6, 2017

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Scania AB (publ.)		
Corporate Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2
Nordic Regional Scale	--/--/K-1	--/--/K-1
South Africa National Scale	zaAAA/--/zaA-1+	zaAAA/--/zaA-1+
Scania CV AB		
Senior Unsecured	BBB+	BBB+
Commercial Paper	K-1	K-1

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.